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SUBJECT: ZHEJIANG LEADERS CONFIDENT IN TRADE TIES WITH UNITED STATES
DESPITE CURRENT DIFFICULTIES

REF: SHANGHAI 313

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Summary

1. (SBU) Zhejiang Province enjoys a good relationship with the United States built on a foundation of strong trade ties, provincial and local officials told the Consul General on his farewell trip to Hangzhou, Zhejiang's provincial capital on August 6-7. Zhejiang officials remain concerned that the slowing economy in the United States, as well as other factors, including RMB appreciation and rising labor costs, is adversely affecting the province's exports, but they hope the challenging economic landscape will provide needed impetus to reform the structure of the province's economy towards more energy-efficient production. Zhejiang companies also are looking outwards to invest globally and within China to offset slowing exports. End Summary.

Zhejiang's Good Relations with the United States

2. (SBU) Zhejiang Provincial Party Secretary Zhao Hongzhu told departing Consul General and Poloff on August 6 that Zhejiang has a strong relationship with the United States, as evidenced by his many meetings with Ambassador Randt and the Consul General since Zhao assumed office in March 2007. Business and cultural exchanges with the United States are growing and Party Secretary Zhao said he hopes to visit the United States in the next year. Zhejiang's relations with the United States remain primarily trade-related. U.S.-Zhejiang trade exceeded USD 28 billion in 2007, and the Party Secretary said total trade is on pace to exceed last year's total, having reached USD 14.7 billion through the first half of 2008. During a separate meeting August 7, Hangzhou Mayor Cai Qi conveyed similar sentiments. In fact, Cai had just returned from a visit to San Francisco and Boston the night before.

Impact of the U.S. Economic Slowdown on Zhejiang

3. (SBU) With a heavy reliance on exports, Zhejiang definitely is adversely affected by the economic slowdown in the United States, officials said. Party Secretary Zhao said trade with

the United States will continue to increase but he expects the rate of increase to be slower in the future. Not surprisingly, low-end processing industries that are geared towards exports have been hit hardest by the U.S. economic situation, officials said. Zhao stated that the slowing U.S. economy, higher global energy prices, RMB appreciation, and the new Labor Contract Law all are factors in Zhejiang's own economic difficulties. During an August 7 visit to the Wanxiang Group, China's largest auto parts supplier, Chairman Lu Guanqiu agreed that there are a number of factors contributing to slower growth, and companies will need to stay ahead of the curve by cutting costs. (Note: Businessmen in Zhejiang's Yiwu shared similar concerns with the Consul General during his recent visit there (see reftel). End Note.)

Zhejiang's Focus on Economic Restructuring

14. (SBU) Our contacts uniformly told the Consul General, however, that Zhejiang's current economic difficulties provide the impetus for economic restructuring towards production that is less energy-intensive and more hi-tech. Mayor Cai, for example, said Hangzhou wants to transform Hangzhou's economy from processing industries to hi-tech, outsourcing, financial services, and tourism. Cai said he was favorably impressed by Silicon Valley during his visit to the United States. Silicon Valley, Cai said, takes advantage of bright, young minds, bringing investors together with a top university (Stanford) to build innovative new companies. In addition to developing new hi-tech companies, Hangzhou is building a new convention center in the hopes of attracting more tourists, Cai said.

15. (SBU) Party Secretary Zhao added that the province will move away from processing industries, such as textiles, in an effort to develop in a more environmentally friendly way as per the Central Government's mandate. Zhejiang's private sector also is likely to move away from highly labor-intensive industries as

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labor costs rise. Wanxiang's Lu said his company is encouraging more mechanization in the face of rising labor costs, which have increased 20 percent in the past two years.

Outward Investment

16. (SBU) To offset losses on the export front, Zhejiang companies increasingly are looking outside the province for investment opportunities, officials said. Party Secretary Zhao stated that Zhejiang companies are investing both globally and in other parts of China. Geely, the Zhejiang-based auto manufacturer, for example, has factories in Mexico, Thailand, Russia, and Vietnam, he said. Zhejiang companies also are investing in Central China, as those textile mills and other processing industries that close in Zhejiang may relocate to Jiangxi Province or Hubei Province.

Investment Disputes

17. (SBU) During the meeting with Mayor Cai, the Consul General raised a dispute involving Ewing Management Group, a U.S. company. The Mayor was not familiar with the problem but asked staff from the foreign trade commission to look into the situation. During the dinner with Party Secretary Zhao, the CG asked about the impact of the Wahaha-Danon dispute on perceptions of Zhejiang's investment climate. Zhao said the provincial government has spent considerable time trying to mediate the dispute. He did not believe the altercation would hurt Zhejiang's image. At this stage, the main outstanding issue is agreeing on a price for ending the partnership.

Olympics

18. (SBU) Party Secretary Zhao said he is looking forward to the

Olympics, and the Chinese Government is encouraged by President Bush's visit to Beijing to watch the Games. Zhejiang Province has 26 athletes on the Chinese Olympic team with a chance for possibly five gold medals, Zhao said. (Note: Zhao attended the Olympic Opening Ceremony in Beijing on August 8. End Note.)

Ambassador John Leighton Stuart

19. (SBU) The Director General of Zhejiang's Provincial Foreign Affairs Office confirmed that he is familiar with plans to return Ambassador John Leighton Stuart's ashes to Hangzhou in November. The Provincial Government is supportive of the event and does not foresee any problems, he said. (Note: Stuart was born in Hangzhou in 1876 and later was U.S. Ambassador to China from 1946 to 1949, departing China just weeks before Mao Zedong proclaimed the founding of the People's Republic of China. End Note.)
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